DEC 6 1952

IN THE

SUPREME COURT OF THE UNITED STATES.

OCTOBER TERM, 1952.

No. 482

MARGARET PENN,
Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

PETITION FOR REVIEW ON WRIT OF CERTIORARI
and
BRIEF IN SUPPORT THEREOF.

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IN THE

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MARGARET PENN,
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PETITION FOR CERTIORARI

To the United States Court of Appeals for the Eighth Circuit.

To the Honorable the Chief Justice and the Associate Justices of the Supreme Court of the United States:

Petitioner, Margaret Penn, hereby respectfully petitions for a Writ of Certiorari to review the judgment of the United States Court of Appeals for the Eighth Circuit in the cause therein No. 14,546, entitled "Margaret Penn, Petitioner, v. Commissioner of Internal Revenue, Respondent."

SUMMARY AND SHORT STATEMENT.

The allowable nature of a deduction, in the field of income taxation, indicates the case here presented.

Petitioner, a 73-year-old life tenant of realty (land), was compelled (economically) to and did, without the consent of the remainderman, erect a building thereon with her own funds and for her sole benefit (R. 23).

She claimed the right (recognized in **Caroline T. Kissel**, 15 B. T. A. 705) to a yearly amortization of the amount of her investment, over her life expectancy of 7.26 years, as income tax deductions; but the Court below (affirming the Tax Court) adjudged that she was entitled only to the conventional depreciation of 2% for each of the 50 years of estimated useful life of the building (R. 76).

The question here presented [strikingly posed against the directly opposite tax treatment accorded by Regulation 111, sec. 29.23 (a)-10, to a lessee of realty in exactly the same circumstances] is, therefore, whether the petitioner is entitled thus to amortize.

Below, it was held that sec. 23 (l) of Title 26 of the U. S. Code (having to do only with the "generality of cases" and, we also respectfully submit, not intended to provide for the unusual situation where, as here, the life tenant herself actually **creates** the depreciable property) controlled—said section reading:

> "**Depreciation.** A reasonable allowance for the exhaustion, wear and tear (including a reasonable allowance for obsolescence)—
>
> (1) of property used in the trade or business, or
>
> (2) of property held for the production of income.
>
> In the case of property held by one person for life with remainder to another person, the deduction shall be

computed as if the life tenant were the absolute owner of the property and shall be allowed to the life tenant. In the case of property held in trust the allowable deduction shall be apportioned between the income beneficiaries and the trustee in accordance with the pertinent provisions of the instrument creating the trust, or, in the absence of such provisions, on the basis of the trust income allocable to each."

BASIS OF JURISDICTION.

This Court is believed to have jurisdiction to review the judgment below under the provisions of section 1254 of Title 28, U. S. Code, providing that civil cases in the Courts of Appeals may be reviewed in this Court by Writ of Certiorari.

The judgment below was rendered on October 23, 1952 (R. 77); the opinion below appears at page 71 of the Record; while this Petition is being presented in December, 1952.

THE QUESTION PRESENTED.

This is stated as follows:

1. Was said section 23 (l) intended to govern the situation where a life tenant of realty creates the depreciable property by herself erecting thereon the depreciable property?

2. Did not the Court below err in ruling that such life tenant was entitled only to conventional depreciation during the estimated useful life of the building under said section?

3. Is not the judgment below also in conflict with the rule for statutory construction declared in **Gould v. Gould**, 245 U. S. 151, 153?

REASONS RELIED ON FOR THE WRIT.

The proper interpretation of said section 23 (l), in light of the described special state of facts, is now presented as a question believed to be of first impression in this Court; the matter involved is of very substantial practical importance, generally, to the taxpayers.

Whether a life tenant of land, erecting an improvement thereon at his or her own expense, is to be permitted to depreciate the improvement or amortize the investment over his or her life expectancy (as a lessee is so allowed over the terms of his or her lease) may well affect the action of any person holding a life tenancy in realty when determining whether a useful improvement thereon is to be made.

Additionally, if any doubt exists over the question of petitioner's lawful right to amortize, under the provisions of said section, because of the fact that she herself created the depreciable property and thus distinguished her situation from the statutory "generality of cases," she, as taxpayer, is entitled to the benefit of any such doubt in the light of **Gould v. Gould**, 245 U. S. 151, 153—an income tax case—reading:

> "In the interpretation of statutes levying taxes it is the established rule not to extend their provisions, by implication, beyond the clear import of the language used, or to enlarge their operations so as to embrace matters not specifically pointed out. In case of doubt they are construed most strongly against the Government and in favor of the citizen."

Within the language of Rule 38 (5-b) it is now submitted that the Court below has decided an important question of Federal law which has not been, but should be, settled by this Court, and that that Court has decided a Federal ques-

tion in a way in conflict with said applicable decision of this Court.

Wherefore, petitioner, Margaret Penn, prays issuance of the Writ of Certiorari to review said judgment of the United States Court of Appeals for the Eighth Circuit in the cause therein entitled "Margaret Penn, Petitioner, v. Commissioner of Internal Revenue, Respondent," No. 14,546, and that said judgment below be reversed, and for all proper relief.

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BRIEF IN SUPPORT OF PETITION.

JURISDICTION.

The jurisdiction of this Court is invoked under Section 1254 of Title 28, United States Code, which grants to this Court the power to review by writ of certiorari any civil case in the courts of appeals, whether before or after rendition of judgment or decree.

STATEMENT OF THE CASE.

This case arises on a petition for review on writ of certiorari to the United States Court of Appeals for the Eighth Circuit, the judgment of which court affirmed a decision of The Tax Court determining a deficiency in petitioner's income tax for the years 1943 and 1944.

The question involved herein is whether a life tenant of real property, who improved the property at her own expense, may amortize the cost of those improvements on the basis of her life expectancy. The taxes involved are income and victory taxes for the year 1943, and income taxes for the year 1944.

On July 9, 1907, petitioner's husband (now deceased) received in a partition of his deceased father's estate the real property on which the disputed improvements were later made (R. 24-28). On June 25, 1913, petitioner and her husband entered into an indenture in which this same real property was conveyed to their daughter, Gladys Lucille Penn (R. 16-19). Petitioner and her husband, by the terms of said indenture, reserved to themselves and to the survivor a life estate in said real estate obligating themselves during their lives that the real estate should be kept, leased and rented to tenants for the best rents obtainable therefor, and that out of the money obtained from said rents the building should be kept in good repair and condition (R. 17). Upon the death of petitioner and

her husband, a court of competent jurisdiction was to appoint a trustee to manage the property and pay over to the daughter the income therefrom. Upon the death of the daughter, the real estate was then to descend to the heirs of her body (R. 18). At the end of the deed it was stated that petitioner and her husband were making the conveyance for the purpose of assuring to their daughter a fixed income after their deaths (R. 18).

On the real estate above mentioned there was located a three-story brick building (R. 21). In 1938 petitioner's husband had been dead for many years; the building on the real estate was some sixty years old; the second and third floors had become entirely vacant and the first floor practically so. The only tenant remaining was a small cigar store on the first floor. The building had become completely obsolete, out of date and untenantable (R. 21). In 1938 petitioner, without aproval of her daughter, tore down the old building and at her own expense erected a new building at a cost to her of $17,628.45 (R. 16).

In 1938 petitioner was 73 years old and had a life expectancy of 7.26 years (R. 16). The purpose for which petitioner erected the new building was to get something out of her life estate in the realty (R. 21). Mrs. Penn's motive in building this structure was to provide for her own income for her own needs (R. 23).

From 1938 to 1943 petitioner received $4,000 or $5,000 a year rental on the new building. From 1943 to 1950, inclusive, the rents from this building were as follows: 1943, $5,680; 1944, $6,900; 1945, $6,975; 1946, $7,525; 1947, $9,895; 1948, $10,950; 1949, $11,010; 1950, $9,660 (R. 21-22). The approximate annual expenses on the building have been well under $1,000 (R. 21-22).

In 1938 petitioner was a woman of moderate means; she grossed $5,000 a year from two other pieces of realty (R. 22).

Petitioner sued the contractor who had erected the new building for her in 1943 or 1944. The case was settled about three years ago for $3,000, and at that time the $3,000 was put into the form of a cashier's check payable to the next succeeding life tenant to be used with such other money as might be necessary to fix the defective outer wall by replacing it with brick or some other substance (R. 23).

Petitioner was 87 years old in June, 1952; she is and was confined to her bed and wheelchair, and was not able to testify (R. 20).

The cost of the erection of the building to petitioner was $17,628.45. In 1943 and 1944 she deducted $2,500 in each year to amortize that cost over the approximately seven years of her life expectance (R. 31 and 41). The Commissioner proposed to assess a deficiency for each of those years, allowing a depreciation of 2% per annum of the cost on the basis that the building had a fifty year life (R. 11 and 13).

The petitioner filed a petition in the Tax Court to redetermine the deficiencies. The Tax Court sustained the Commissioner and held that under the provisions of Section 23 (l) of the Internal Revenue Code, petitioner was entitled to a deduction based upon the estimated useful life of the building (R. 47). The Tax Court ordered and decided that there were deficiencies in income tax of petitioner for the calendar years 1943 and 1944 in the respective amounts of $550.53 and $776.04 (R. 64). From this order, petitioner below brought a petition for review in the United States Court of Appeals for the Eighth Circuit (R. 65-66). In an opinion dated October 23, 1952, said Court of Appeals affirmed the decision of The Tax Court (R. 71), and the judgment of that Court was entered on the same date (R. 77). From that judgment petitioner brings this petition for review on writ of certiorari.

SPECIFICATION OF ERRORS.

I. The United States Court of Appeals for the Eighth Circuit erred in ruling that under Sec. 23 (l) of the Internal Revenue Code, depreciation should be allowed to petitioner on the basis of the useful life of the building instead of on the remaining life expectancy of petitioner.

II. The United States Court of Appeals for the Eighth Circuit erred in ruling that Section 23 (k) of the Internal Revenue Act of 1928 [now Section 23 (l) of the Internal Revenue Code], providing that the deduction for allowance for exhaustion shall be computed as if the life tenant were the absolute owner of the property, applies to improvements placed on the property by a life tenant at her own expense.

ARGUMENT.

Summary.

The principal point in petitioner's case is that it was settled by the Board of Tax Appeals in **Caroline T. Kissel**, 15 B. T. A. 705 (1929), that under the Revenue Act of 1921 a life tenant who makes improvements with his own money on the property in which he has only a life interest may amortize the cost thereof over the number of years of his remaining life expectancy just as one who purchases a life interest pur autre vie may amortize his purchase price over the life expectancy of the life tenant, and just as a lessee may amortize the cost of his improvements over the life of the lease; that the amendment by the Revenue Act of 1928, Section 23 (k), adding the provision that in the case of property held by one person for life with remainder to another person the deduction shall be computed as if the life tenant were the absolute owner of the property, was not intended to and did not change the rule in the **Kissel** case, but applies to property at the time of the vesting of the life interest and not to improvements made by the life tenant out of his own pocket.

This presents an important question of interpretation of the Internal Revenue Code; upon this decision will depend whether or not life tenants in the future will be willing to make improvements on real estate in which they have a life tenancy. Obviously, remaindermen will not be willing to do so since they are not permitted to make any deductions for depreciation during the life tenancy, and if the life tenant cannot recover his expenditures during his lifetime, it will throw a substantial roadblock against improvements. Lessees frequently make improvements whose natural lives will extend beyond the leases; if life tenants have the same tax treatment it may be reasonable to expect they will like-

wise contribute to the improvement of their property and thus of the community. For the first time this Court has the opportunity to answer this question.

Argument in Chief.

The Internal Revenue Code, Sec. 23, entitled "Deductions from Gross Income," reads as follows:

> "In computing net income there shall be allowed as deductions:
>
> * * * * * * *
>
> "(1) Depreciation.—A reasonable allowance for the exhaustion, wear and tear (including a reasonable allowance for obsolescence)—
>
> "(1) of property used in the trade or business, or
>
> "(2) of property held for the production of income. In the case of property held by one person for life with remainder to another person, the deduction shall be computed as if the life tenant were the absolute owner of the property and shall be allowed to the life tenant."

The instant case is governed by **Caroline T. Kissel**, 15 B. T. A. 705 (1929). In that case, the Board of Tax Appeals found the following facts: During the taxable year 1921, petitioner acquired a life estate in certain lands. Because the buildings or improvements on this land were old and unproductive of an amount of revenue satisfactory to the petitioner, she razed them and constructed a four story brick building which cost $113,727.51. The new building was rented and put to use in November of 1921. The petitioner was then 63 years of age and her life expectancy was 11.039 years. Respondent-Commissioner of Internal Revenue allowed a deduction for depreciation at the rate of 2% per annum; petitioner maintained the depreciation percentage should be based upon her life expectancy.

The **Kissel** case involved income tax for 1921, and the decision involved the Revenue Act of that year which provided as follows:

> "Sec. 214 (a) That in computing net income there shall be allowed as deductions:
>
> * * * * * * * *
>
> "(8) A reasonable allowance for the exhaustion, wear and tear of property used in the trade or business, including a reasonable allowance for obsolescence."

The Board of Tax Appeals held that, although the improvements were erected voluntarily and not pursuant to any mandatory provision, it was nevertheless permissible for taxpayer to amortize the cost of the building based upon her life expectancy, just as in the case of a lessee erecting improvements whose useful life is expected to exceed the term of the lease; and that under the provisions of Section 214 (a) (8) the life tenant could amortize the cost of her improvements on the basis of her life expectancy.

The Board further held that Section 215 (b) [now Section 24 (d) of the Internal Revenue Code] forbidding holders of life interests to deduct shrinkage in the value of their interests due to lapse of time, relates only to the interests acquired by gift, bequest, or inheritance (15 B. T. A., at 709). The Board added that, since petitioner had acquired her interest in the new building by paying for it out of her own funds, she was in the same position as though her interest was that of a lessee for life.

The principle of permitting the life tenant to deduct, by way of depreciation, his own investment based upon his life expectancy was approved in **Grant v. Rose,** 32 F. 2d 812 (D. C. Ga., 1929), Aff'd sub nom **Rose v. Grant,** 39 F. 2d 338 (5th Cir., 1930). This case was governed by the

Revenue Act of 1921. However, the principle was reaffirmed in **H. Edward Wolff**, 7 T. C. 717, 721 (1946), decided under the present law.

The **Kissel** case is directly in point. In both cases the petitioner, a woman of advanced years, made improvements on real property in an effort to improve her current financial position. In the **Kissel** case the building cost $113,727.51; in the case at bar the building cost $17,628.45. In the **Kissel** case the taxpayer was 63 years of age with a life expectancy of approximately 11 years; in the case at bar the taxpayer was 73 years of age with a life expectancy of approximately 7 years. In each case the taxpayer had a life interest followed by an estate in her child or children. In the **Kissel** case the property was derived from the taxpayer's father; in the case at bar from the taxpayer's husband. The dispute between the Government and the taxpayer was identical to that in the case at bar. This and the other cases cited fully establish the principle for which petitioner contends.

The Commissioner's position in this case is that the **Kissel** case was decided under the Revenue Act of 1921, and that in 1928 the section was amended so as to add the provision that in the case of property held by one person for life with remainder to another person the deduction shall be computed as if the life tenant were the absolute owner of the property and therefore since 1928 the deduction must be based on the life of the property and not the life of the life tenant, even where the life tenant makes the improvements. The United States Court of Appeals for the Eighth Circuit below sustained this contention of the Commissioner, interpreting the word "property" as meaning the physical property.

This interpretation of the meaning of Section 23 (l) is erroneous.

It will, we think, be of aid to the Court in interpreting this statute briefly to review its history.

The Revenue Act of 1921 provided as follows:

"Sec. 214. (a) That in computing net income there shall be allowed as deduction:

* * * * * * *

"(8) A reasonable allowance for the exhaustion, wear and tear of property used in the trade or business, including a reasonable allowance for obsolescense."

The Board of Tax Appeals in the **Kissel** case (15 B. T. A., at 707-9) held that a life estate is property within the meaning of that section. In reaching this conclusion the Board cited **Lynch v. Alworth-Stephens Co.**, 267 U. S. 364, holding that a lease was property for the purpose of exhaustion, and **Duffy v. Central Railroad Company of New Jersey**, 268 U. S. 55, holding that a lessee who erected improvements on leased property must apportion the cost of the improvements over the life of the lease. The Board further held that if Section 214 (a) (8) stood alone it would be compelled to hold petitioner had the right to exhaust the cost of her improvements over her life expectancy.

The Board went on to point out that the fact that deductions may not be taken for shrinkage in the value of a life interest due to the lapse of time where the life interest is acquired by gift, bequest or inheritance is an exception to Section 214 (a) (8), but is limited to a life interest so acquired, and that improvement made at the life tenant's own expenditure were not within that exception, and hence are amortizable over the remaining life of the life tenant. The Board pointed out the petitioner was legally in the same position as though her interest were a lease of a life interest.

Under the 1921 Act it was the general rule that in the case of improvements existing at the time of the creation

of the life interest, the life tenant ordinarily could not deduct depreciation but the loss fell on the remainderman.

Kaufmann v. Commissioner, 44 F. (2d) 144.

This created difficulty, and in the 1926 Revenue Act the following clause was added to subsection (8) of Sec. 214 (a):

> "In the case of improved real estate held by one person for life with remainder to another person, the deduction provided for in this paragraph shall be equitably apportioned between the life tenant and the remainderman under rules and regulations prescribed by the Commissioner with the approval of the Secretary."

This addition was not intended to overturn the rule in the **Kissel** case relating to improvements placed on the property by the life tenant, but to provide for the apportionment of the exhaustion of existing improvements between the life tenant and the remainderman.

That the Treasury clearly understood that this additional clause providing for apportionment applied only to existing improvements is clearly shown by the terms of I. T. 2418, an executive decision interpreting the apportionment called for by the 1926 Amendment. In I. T. 2418, the Bureau provided that the remainderman could not have any deduction for exhaustion during the life estate, and the life tenant's proportion of the allowance on the depreciable property whose useful life would exceed the probable duration of the life estate was to be fixed by the ratio of the market value of the life estate to that of the remainder **on the date of the vesting of the life tenant's interest.**

That had nothing to do with the amortization of the cost of improvements put on the property by the life tenant after her interest vested. The ruling clearly shows that the Treasury understood that the Amendment of 1926 was

intended to apply to existing improvements and not those placed on the property by the life tenant. Stating the matter differently, the Amendment of 1926 was intended as a relief provision for the life tenant as to existing improvements and not as a curtailment of the right of the life tenant to amortize over his life the cost of improvements he might make.

This complicated formula for apportioning depreciation was unworkable, so Congress, by the Revenue Act of 1928, changed the added clause to read as follows:

> "In the case of property held by one person for life with remainder to another person, the deduction shall be computed as if the life tenant were the absolute owner of the property and shall be allowed to the life tenant." Revenue Act of 1928, Section 23 (k).

That Act also added another sentence relating to apportionment of the deduction between income beneficiaries and trustees in accordance with the provisions of the trust instrument, a provision not pertinent here.

Congress, by the above Amendment of 1928, was still dealing with the same problem, namely, the depreciation or exhaustion of improvements existing at the time the life tenant's interest became vested.

It will be noted also that the words "improved real estate" in the added clause were changed to the word "property".

The meaning of the word "property" as used in the 1928 Amendment obviously has the same meaning as the words "improved real estate" in the 1926 Amendment.

Nevertheless, Congress did not thereby restrict the meaning of the word "property" as used in the first clause of the section permitting deduction for "a reasonable allowance for the exhaustion, wear and tear of property used in

the trade or business." The use of the word "property" in that first clause still means all forms of property including life interests and leases.

The word "property" has many meanings and, like so many words in our language and in the law, its meaning depends on the context. As the late Mr. Justice Holmes once said, a word does not have a fixed or rigid meaning but is "the skin of a living thought." Obviously, when the statute speaks of property held by one person for life with remainder to another person, the physical property, consisting of the improved real estate, is intended; that is to say, the physical property which is subject to the two estates, the life interest and the remainder. That, however, does not limit the meaning of the word "property" used in the first and principal sentence, permitting the deduction for exhaustion. The word "property" in the first clause includes the estates themselves in the property, including leaseholds, the cost of improvements made by lessees, life interests and the cost of improvements made by life tenants. The word "property" used in that original clause is also broad enough in the case of a fee to include the physical improved real estate, but it is not so limited. The basic difficulty with the reasoning of the Tax Court below was its failure to recognize the difference between property in its narrow physical sense and in its more general meaning. As the Fourth Circuit has said:

> "Property is a term of very broad signification, embracing everything that has exchangeable value or goes to make up a man's wealth—every interest or estate which the law regards of sufficient value for judicial recognition." Samet v. Farmers' and Merchants' National Bank, 247 Fed. 669, 671.

In this connection it will be noted that Congress did not change Section 215 (b) of the 1921 Act, now Section 24 (d) of the Code, which provides that no deduction shall

be permitted to the life tenant for shrinkage in the value of his life interest due to lapse of time where he acquires the interest by gift, bequest or inheritance. That section clearly implies, as the **Kissel** case held, that the holder of a life interest who acquired it by purchase or by making improvements out of his own funds can deduct the shrinkage in the value of his investment due to lapse of time. That section is still the law. An investment by a life tenant in the purchase or improvement of his own life estate, not having been derived by gift, is still property which he can amortize over his life interest under Section 23 (1), and that is the holding of the Tax Court under the present law.

H. Edward Wolff, 7 T. C. 717, 721 (1946).

It should be borne in mind that the taxpayer is entitled to the benefit of any doubt as to whether Congress was legislating for the generality of cases, as petitioner contends, or whether it intended to include such a situation as this where a life tenant uses her own funds to construct the improvements. Petitioner's contention is, as stated above, that Congress had no intention to cover the unusual situation where the life tenant expends her own funds, and further that petitioner is entitled to the benefit of any doubt as to whether or not Congress did so intend.

Gould v. Gould, 245 U. S. 151.

The writ of certiorari should be granted and the judgment of the United States Court of Appeals for the Eighth Circuit should be reversed.

Respectfully submitted,

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